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Fixing DC's Rainy Day Fund

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In 2000, the District established two new fiscal reserves, an "emergency reserve" and a "contingency reserve," as required by Congress in that year's appropriations legislation. These reserves are similar to the "rainy day" funds that most states use as a cushion against major crises that could disrupt the budget — such as a natural disaster or a rapid drop in revenues during an economic downturn.

When the reserves were established, it was assumed that it would take the District up to seven years to reach the target level, which was set at seven percent of the local budget. The District's strong finances in 2000 and 2001, however, allowed it to meet this level in just two years. By the end of fiscal year 2002, the District had set aside more than $250 million of local revenues in the emergency and contingency reserves.

Rainy day funds can play a significant role in helping states and cities manage a fiscal crisis. In particular, they can help maintain public services during an economic downturn, when rising unemployment and falling incomes lead to increasing need for government services. Rainy day funds also limit the need to raise revenues at a time when families and businesses are least able to afford tax increases. Finally, spending rainy day reserves provides a stimulus to the local economy that can help mitigate the effects of a recession.

The federal law governing DC's rainy day reserves, however, includes several restrictions that make it difficult for the District to take advantage of this important strategy. Partly as a result of these restrictions, Mayor Williams and the DC Council chose not to use the rainy day funds to address a $323 million shortfall identified in September 2002. Instead, the deficit was eliminated entirely through substantial spending cuts and revenue increases.

This report compares the District's reserve funds with the rainy day funds in other states. Throughout this report, the DC emergency and contingency reserves are described as the District's "rainy day fund." This review finds that the rules governing DC's rainy day fund are more restrictive than in almost any other state.

- Most significantly, funds withdrawn from the DC rainy day fund in a given year must be replenished in full in the following year. Because a fiscal crisis can last more than one year, this rule could require the District to repay a withdrawal before its finances have recovered. As a result, District officials are unlikely to ever consider making more than a modest withdrawal from the rainy day funds.

- Of 45 states with a rainy day fund, 39 have no replenishment requirement. In these states, contributions to the rainy day fund typically are not required until fiscal conditions recover — such as when the state returns to budget surpluses or when revenues begin to grow at a healthy rate. Among the six states with a replenishment rule, no state requires repayment as rapidly as in the District.

While the rapid replenishment rule is the most significant barrier to using the District's rainy day fund, other rules limit access in ways that are more restrictive than in most state rainy day funds.

- Both components of DC's rainy day fund — the emergency reserve and the contingency reserve — can be used to address a natural disaster or other emergencies. But only the contingency reserve — which totals roughly $100 million — can be used in response to a revenue shortfall. In effect, this means that the District has a $250 million rainy day fund to respond to natural disasters, but only a $100 million reserve to respond to an economic downturn.

- Moreover, the $100 million contingency reserve can be accessed only if revenue collections fall more than five percent below the level projected when the budget was enacted. This means that the District can use these funds when it faces an unexpected revenue shortfall, but not when weak revenue collections are anticipated in advance. If, for example, revenues are projected to fall 10 percent from one year to the next — and this projection proves to be accurate — the District could not use its rainy day fund to address the decline. Even if the District does face an unexpected revenue shortfall, it must exceed five percent before the rainy day fund can be accessed. This means that rainy day funds could be used only if there is an unanticipated shortfall that exceeds $175 million.

By contrast, most state rainy day funds give policy makers great flexibility to determine when to use the reserves.

- In 21 states, the rainy day fund can be used when the state faces a deficit for any reason. In another 18 states, the rainy day fund can be tapped when a budget deficit results from a revenue shortfall — that is, when actual revenue collections in a given year are less than the revenue projection upon which the budget was based.

- Most states allow use of the rainy day fund for natural disasters or other emergencies, but no state restricts a portion of its rainy day fund for this purpose as the District does. Only six states require that economic or revenue conditions decline by a specified amount before the rainy day fund can be used.

- While policy makers in most states have discretion to determine when fiscal conditions are weak enough to necessitate using the rainy day fund, some state rainy day funds include rules designed to limit access. Ten states require a super-majority vote of the legislature, such as three-fifths, to make a withdrawal from their rainy day fund. And 10 states limit the amount that can be withdrawn at one time. In Idaho, for example, no more than half of the fund's full balance can be used in a given year.

In short, most state rainy day funds are designed to be built up when budget conditions are strong and to give policy makers flexibility to use the rainy day fund when fiscal conditions deteriorate. Most states with rainy day funds — 32 of 45, including Maryland and Virginia — have used this flexibility to make one or more rainy day fund withdrawals to address the current budget crisis. The withdrawals total nearly $14 billion nationwide, more than half of the aggregate rainy day fund balances.

This review suggests that the District's rainy day fund should be modified to adopt the best features of other state rainy day funds. Without these changes, the District may never be able to make significant use of this valuable fiscal tool. Because the District is in the midst of a fiscal downturn that is expected to continue through at least 2004 — and because significant spending reductions and revenue increases already have been implemented in response to these fiscal problems — it is important to consider these modifications now.

Since DC's rainy day fund was established under federal law, changes must be made by the U.S. Congress. Among the changes that should be considered are:

The replenishment rule should be replaced. Any rule requiring replenishment of rainy day fund withdrawals within a specified time period — even a period of several years — could require repayments at a time when fiscal conditions remain weak. As a result, the replenishment rule in the District's rainy day fund should be replaced with rules requiring contributions when fiscal conditions are healthy.

One option is to require a contribution to the rainy day fund to be included in the District's budget in any year when revenues are projected to exceed the costs of maintaining existing programs and services. A second option is to require a contribution when the District ends the year with a budget surplus. Alternatively, both of these provisions could be required.

District policy makers should have more discretion over when to use the rainy day fund. Rather than maintaining two separate reserves, DC's two rainy day funds should be combined into one fund that can be used for *either* a natural disaster or a revenue shortfall.

In addition, Congress should consider several modifications to give greater flexibility to the mayor and Council to use the rainy day fund to address a revenue shortfall. In general, use of the rainy fund should be allowed whenever worsening revenue collections lead to a deficit — as is the case in most state rainy day funds. This means that District officials should be able to appropriate funds from the rainy day reserve in the annual budget if projected revenues are not sufficient to maintain existing programs and services. Withdrawals also should be allowed after the budget is enacted when revenue collections fall by any amount below the level assumed in the budget, rather than the five percent threshold in current law.

While these changes would improve the rainy day fund, they could raise concerns that the rainy day fund would be relied upon too readily to address budget shortfalls. One possibility for addressing that concern is to limit the amount of the rainy day fund that could be withdrawn in a given year. Limiting withdrawals to half of the fund's target level, for example, would allow the District to use no more than $125 million in a given year.

The structure of rainy day funds in other states and recommendations for improving DC's rainy day funds are discussed in more detail below.

The District's Replenishment Rule Is Extremely Restrictive

Under the District's rainy day fund, a withdrawal in a given year must be repaid in full in the subsequent year. This provision greatly limits the ability of the District to benefit from its rainy day fund. Fiscal crises often last two or three years, and even when recovery from a downturn begins, it often is modest at first. If the District faced budget problems that were serious enough to warrant a withdrawal from the rainy day fund, it probably would not be able to replenish the reserves fully in the next year without cutting spending or raising taxes. This provision makes it unlikely that District officials will ever consider making significant use of the rainy day fund.

The rule for maintaining the balance in the District's rainy day fund is more restrictive than in every state with a rainy day fund.

- Only six states require that withdrawals from the rainy day fund be replenished in a specified period. The lack of replenishment rules in most states likely reflects the fact that such a requirement could force the state to begin re-building its rainy day fund before the end of the fiscal crisis that necessitated the withdrawal.

- Of the states that require replenishment of withdrawals from their rainy day fund, three — New York, Florida, and Alabama — allow replenishment to occur over a period of five years or more. The lengthy period helps ensure that replenishment will occur after the fiscal crisis is over.

- In South Carolina and Missouri, withdrawals from the rainy day fund are repaid over a three year period, and in Rhode Island, the replenishment period is two years.[1]

[1] The statute governing Rhode Island's rainy day fund allows the repayment period to be lengthened beyond two years.

Most States Contribute to Rainy Day Funds Only When Fiscal Conditions Are Strong

In the majority of states with rainy day funds, contribution rules are designed so that rainy day fund deposits are made only when the state has more revenues than needed to meet its ongoing expenditure needs.

- In 25 states, deposits to the rainy day fund are required when the state has a year-end budget surplus. (A summary of state rainy day funds and their basic provisions is included in Appendix I.) In these states, some or all of the surplus must be placed in the rainy day fund. In Pennsylvania, for example, 25 percent of the annual surplus is devoted to its rainy day fund, while Minnesota devotes all of any budget surplus to its rainy day fund until the fund reaches its target level.

- Some 11 states — Arizona, Florida, Idaho, Indiana, Kentucky, Michigan, Nebraska, New Jersey, Tennessee, Virginia, and Wisconsin — require deposits into the rainy day fund when growth in tax revenues or state economic growth is expected to exceed specified levels. In Idaho, for example, the state contributes to its rainy day fund when revenues are projected to grow by more than four percent.

  While these rules generally are designed so that rainy day fund contributions will be made when fiscal conditions are healthy, they can lead to contribution requirements an times when state finances are not particularly strong. In Tennessee, for example, 10 percent of any revenue increase from one year to the next must be placed in the rainy day fund, which means that a deposit would be required even if revenue growth is modest. For this reason, some states, such as Michigan, allow contribution requirements to be waived.

- Iowa has no specific contribution rules, and the governor and legislature determine how much, if anything, to appropriate to the fund each year. It is likely that appropriations to the rainy day funds in these states are made generally when budget conditions are strong.

Hawaii, Maryland, Missouri, Oregon, and Rhode Island have rules that require annual contributions to their rainy day fund without regard to the state's fiscal conditions. In these states, rainy day fund deposits may be mandated even when the state is facing budget problems. In Maryland, the state must deposit $50 million in its rainy day fund annually. Deposits are made to the Missouri rainy day fund whenever the fund is below its targeted balance. In Hawaii, 40 percent of annual tobacco settlement funds are contributed to the rainy day fund, and in Oregon 18 percent of lottery revenues are placed in the rainy day fund. In Rhode Island, an amount equal to two percent of revenues is set aside each year. In two of these states — Hawaii and Maryland — annual contributions can be fully withdrawn in a given year if needed. Maryland, for example, made contributions to the rainy day fund in both 2002 and 2003, but withdrawals from the fund were greater in each year than the deposits.

Finally, the rainy day funds in Alabama, Alaska, North Dakota, and Wyoming are funded with special sources. The Alabama rainy day fund was established with a one-time deposit, the

Alaska rainy day fund is supported with proceeds from mineral litigation, the North Dakota reserve is funded with profits from the state-operated bank, and the Wyoming rainy day reserve is funded when annual spending is less than budgeted levels.

The District Can Use its Rainy Day Fund Only Under Limited Conditions

The District's rainy day fund has two components, with separate rules governing the use of each.

- The "emergency reserve" — which equals four percent of the budget, or roughly $150 million — is limited for use in response to "unanticipated and non-recurring extraordinary needs of an emergency nature, such as natural disaster or calamity..." or "in the event of a State of Emergency as declared by the Mayor."[2]

- The "contingency reserve" — which equals three percent of the budget, or roughly $100 million — can be used to address either a natural disaster or a shortfall in revenues in an economic downturn.

In several ways, these rules create significant restrictions over the use of the rainy day fund. In particular, they limit the ability of District officials to take advantage of the reserves in an economic downturn.

The majority of the rainy day fund cannot be used to address a revenue shortfall. While both reserves can be used to address a natural disaster, only the contingency reserve can be used in response to a revenue shortfall. In effect, this means that the District has a rainy day fund equal to seven percent of its budget for use in natural disasters, but only a three percent reserve for use in an economic downturn. Put another way, even if the District were to experience a severe decline in revenues that lasted for several years, policy makers would be unable to access $150 million of the rainy day fund.

The portion of the rainy day fund that is available for revenue shortfalls is highly restricted. The law states that the contingency reserve "may be used, if needed, to cover revenue shortfalls experienced by the District government for 3 consecutive months (based on a 2-month rolling average) that are five percent below the budget forecast."[3] In two key ways, this provision makes it difficult to use the rainy day fund even when revenues are declining. First, it allows the District to access these funds in response to an *unexpected* revenue shortfall, but not when a shortfall is anticipated in advance. If, for example, revenues are projected to fall 10 percent from one year to the next — and if that revenue projection proves to be accurate — the District could not use any of its rainy day fund to address the decline. In this example, the rainy day fund could be used only if revenues fall a further five percent beyond the projected level — for a total of 15 percent.

[2]Home Rule Act, Section 450A(a)(4).
[3]Home Rule Act, Section 450A(b)(4).

Second, this provision requires a substantial drop in expected revenues before the rainy day fund can be accessed. Local revenues in the District in fiscal year 2003 are roughly $3.5 billion, which means that the five percent threshold is about $175 million. Thus, for example, the District could not use its rainy day fund to address an unexpected revenue drop of $150 million, even though such a shortfall would be difficult to address without significant service reductions or tax increases.

The restrictions over the use of rainy day reserves in the District are relatively uncommon.

- *No* other state restricts a portion of its rainy day fund for use in response to a natural disaster. Instead, policy makers in most states have access to the full rainy day fund for either a natural disaster *or* an economy-driven revenue shortfall.

- Only six states — Arizona, Indiana, Michigan, Nevada, Oregon, and Virginia — set specific thresholds for revenue shortfalls or economic decline that must be met before the rainy day fund can be accessed. In Virginia, for example, the rainy day fund can be tapped when revenues fall more than two percent below appropriated expenditures. It is worth noting that the rainy day funds in Arizona, Michigan, Nevada, and Oregon include provisions that allow the legislature and governor to waive these rules and make a withdrawal from the rainy day fund even if the specified conditions have not been met.

In the remaining 39 states, policy makers have discretion to determine when use of the rainy day fund is warranted to address a budget shortfall.

- In 21 states, rainy day fund withdrawals are allowed whenever the state faces a deficit, regardless of the factors behind the budget shortfall.

- In 18 states, the rainy day fund can be used when the state faces a budget shortfall as a result of economic decline, such as when actual revenue collections are less than the levels assumed at the time the budget was enacted. In these states, it appears that the rainy day fund cannot be used when a budget gap occurs because expenditures are greater than budgeted levels.

While the vast majority of states thus do not restrict the fiscal conditions under which a rainy day fund can be tapped, some states have other rules designed to limit access to the rainy day fund.

- Ten states — Alaska, Delaware, Hawaii, Louisiana, Missouri, Oklahoma, Oregon, Pennsylvania, Texas, and Washington — require a super-majority vote of the legislature to approve use of the rainy day fund under most circumstances. In these states, three-fifths or two-thirds of the legislature must approve a withdrawal.[4]

- Some 10 states set a limit on the amount of the rainy day fund that can be used at one time. In, Idaho, Louisiana, Missouri, Oklahoma, Tennessee, and Virginia, only a specified percentage of the rainy fund (typically 50 percent) can be withdrawn at one time. In North Dakota, no more than $25 million can be withdrawn at one time. Arizona, Indiana, Michigan use a more complex formula that ties the withdrawal amount to the severity of the state's economic problems.

States Are Relying Heavily on their Rainy Day Funds to Address Current Budget Problems

States are now facing extremely serious fiscal crises. By some accounts, current state budget problems are the worst since World War II. Collectively, states closed budget shortfalls of $50 billion in their enacted budgets for fiscal year 2003. Since adopting their budgets, further gaps totaling nearly $18 billion have been identified, and additional deficits of [$85] billion are projected for 2004. The budget shortfalls largely have resulted from rapid drops in revenue collections stemming from the national economic slowdown, and in particular weak corporate profits and poor performance of the stock market. As noted, the District faced a $323 million budget deficit for 2003, almost entirely due to falling revenues.

Most states have chosen to use their rainy day fund to address the budget shortfall.

- In 2002 and 2003, 32 of 45 states with a rainy day fund made a withdrawal from these reserves. Twelve of these states have made two withdrawals. (See Appendix Table II.)

- In the Washington region, both Virginia and Maryland have tapped their rainy day fund. Virginia has used $248 million of its $716 million fund, while Maryland has used $394 million of the $888 million it had in its rainy day fund at the start of 2002.

- Nationally, rainy day fund withdrawals in 2002 and 2003 total $13.7 billion, or more than half of the total balance of $22.8 billion at the start of 2002.

- As noted, the District has not tapped its rainy day fund to address the current fiscal crisis.

These findings indicate that policy makers in most states feel that budget conditions are sufficiently weak to necessitate use of the rainy day fund.

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[4] Maine and New Hampshire require super-majority votes to use the rainy day fund under certain circumstances. In Maine, a 2/3 vote of the legislature is required to use the rainy day fund for construction projects. In New Hampshire, a 2/3 vote is required if the rainy day fund is used for a purpose other than addressing a revenue shortfall.

Improving DC's Rainy Day Fund

This review suggests that the District's rainy day fund could be improved by adopting some of the best features of other state's rainy day funds. The modifications discussed below are designed to allow withdrawals from the rainy day when the budget falls out of balance due to a revenue shortfall or due to unanticipated expenditures of an emergency nature, such as spending to address a natural disaster. They also are designed to require deposits into the fund when fiscal conditions are strong to help ensure that the District will have a substantial rainy day fund when a fiscal crisis occurs.

Eliminate the Replenishment Rule. The rule requiring full replenishment of withdrawals from DC's rainy day fund within a year creates a substantial disincentive to use of the reserve when needed. Even if the period for replenishment period were extended from one year to several years, as some states do, the District could be required to begin repaying the withdrawal before its fiscal conditions have recovered. Because there is no way to predict how long a fiscal crisis will last, policy makers would be discouraged from using the rainy day fund if they would be required to repay the withdrawal.

For this reason, the District's rainy day fund would be greatly improved if the replenishment rule were eliminated.

Establish requirements for contributions to the rainy day fund when fiscal conditions are strong. If the replenishment rule were abolished, another mechanism would be needed to ensure that the rainy day fund is built up to its target level. There are several options for doing so.

<u>Require contribution when revenues are projected to exceed “baseline” spending needs</u>: Under this option, a contribution to the rainy day fund would be included as part of the budget for the forthcoming year when projected revenues exceed projected expenditures for existing programs and services. Early each year, the District’s Chief Financial Officer develops both a revenue projection and a “baseline” budget for the forthcoming year — which estimates the costs of maintaining current programs and services and meeting other legal obligations. When projected revenues exceed baseline spending needs, the District would be able to afford a contribution to the rainy day fund.

The District’s rainy day fund could be modified to require that some or all of the difference between projected revenues and the baseline budget be contributed to the rainy day fund. One possibility would be to devote half of all revenues in excess of baseline spending needs to the rainy day fund. This would address the need for setting aside funds for a rainy day while also giving policy makers opportunities to put forward new or enhanced policy initiatives when budget conditions are strong.[5]

<u>Tie contributions to budget surplus</u>: Under this option, the District would make a deposit if it ended the year with a budget surplus; either a portion — such as half — or all of the surplus

[5] If this option were adopted, an additional provision would be needed that would allow cancellation of the planned deposit if actual revenue collections in the year are less than had been anticipated.

Improving Access to DC's "Unrestricted Fund Balance" Also Is Important

In addition to changes in the rainy day fund, another way to help the District address temporary fiscal problems is to increase its ability to access to its General Fund balance.

The General Fund balance in many ways is like the District's savings account. The level of the General Fund Balance essentially reflects the accumulated effect of each year's budget surplus or deficits. When the District has a surplus in a given year, the surplus funds are reflected as an increase in the General Fund Balance. A deficit, by contrast, results in a decline in the General Fund Balance.

While some funds in the General Fund Balance are restricted for certain uses, the General Fund balance in some years includes funds that are not restricted for any purpose. In general, the unrestricted portion of DC's General Fund Balance increases any year the District has a budget surplus. While most states have full access to their unrestricted fund balance, the District cannot spend its unrestricted fund balance without congressional permission.

Improving access to the unrestricted General Fund Balance thus could provide District officials with another tool to address fiscal crises. As in the case of the rainy day fund, this change is likely to require congressional action.

could be placed in the rainy day fund. The key advantage of this option is that contributions are made only when they are affordable, when actual revenue collections in a given year exceed actual spending. One disadvantage to this option, however, is that it would not guarantee that the rainy day fund would be built up even when fiscal conditions are strong. If, for example, a budget surplus is projected for a given year, policy makers could choose to use the entire surplus to enhance programs or reduce taxes, rather than setting some aside.

Tie contributions to revenue growth: Under this option, a contribution to the rainy day fund would be required when revenue growth is expected to exceed a specified level. A rainy day fund deposit could be mandated, for example, when revenues are projected to grow five percent or more. The advantage of this method is that it provides greater assurance that the rainy day fund will be built up than would a contribution requirement dependent on budget surpluses. Nevertheless, tying contributions to revenue growth could require a deposit when it may not be affordable. If, for example, revenue collections have been stagnant or declining for several years, a contribution to the rainy day fund may not be appropriate in the first year that revenues begin to grow. It is worth noting that both Virginia and Idaho were required to make a contribution to their rainy day fund in 2002, based on a formula tied to revenue growth, even though both states were facing fiscal problems. For this reason, this approach is less desirable than the others described above.

Finally, the District also could choose to adopt more than one of these approaches. It could, for example, require contribution to the rainy day fund when revenues are projected to exceed baseline spending needs — and also require that some or all of year-end surpluses be dedicated to the rainy day fund.

Allow rainy day funds to be used for *either* a natural disaster or revenue shortfall. The rules that restrict more than half of DC's rainy day fund for response to a natural disaster or other declared emergencies greatly limit the usefulness of the reserves.

The District's rainy day fund would be improved if the two components — the emergency reserve and the contingency reserve — were combined into one reserve that could be used to address either a natural disaster or a revenue shortfall resulting from an economic slowdown. This would give DC policy makers the same flexibility to access the rainy day fund that policy makers in most states have.

Give policy makers greater discretion to determine when the rainy day fund should be used to address a revenue shortfall. Under current rules, use of the rainy day fund may be prohibited even if revenue conditions have deteriorated dramatically. These rules should be modified in the following ways to increase access to the rainy day fund when a revenue shortfall has led to a budget deficit.

<u>Allow money from the rainy day fund to be included in the annual budget when projected revenues fall below the baseline budget</u>: If projected revenues for the forthcoming year are not sufficient to maintain existing program and services, tax increases or spending cuts would be needed to maintain a balanced budget. This is precisely the situation that rainy day funds are designed to address. As a result, the mayor and Council should be able to include an appropriation from the rainy day fund when they prepare the annual budget if that would be needed to maintain current services.

<u>Allow use of the rainy day fund if revenues fall below projections after the budget is enacted</u>: Under current rules governing the rainy day fund, a withdrawal can be made only if actual revenue collections fall more than five percent below the revenue level projected at the time the budget was enacted.

As noted earlier, this sets a relatively high hurdle for using the rainy day fund. The District's rainy day fund would be improved if withdrawals were allowed during the year when revenue collections fall *by any amount* below the level upon which the budget was based, rather than five percent.

<u>Do not establish a super-majority requirement</u>: Some states require that three-fifth or two-thirds of the legislature support use of the rainy day fund. These super-majority requirements clearly limit access to rainy day funds. For this reason, the District should not adopt a super-majority requirement.

<u>Consider setting a limit an annual withdrawal amounts</u>: As noted, some states give policy makers broad discretion to determine *when* to use the rainy day fund but set a limit on *how much* can be used in a given year. Because the proposed changes to DC's rainy day fund would give the mayor and Council greater access to the rainy day fund, which may raise concerns that the rainy day fund would be relied upon too readily to address budget shortfalls, a limit could be set on withdrawals from the fund. Limiting withdrawals to half of the fund, for example, would allow the District to use no more than $125 million in a given year.

Should DC Use its Rainy Day Fund Now?

As noted, District officials chose not to use the rainy day fund to address the fiscal year 2003 budget deficit of $323 million shortfall. While this decision partly reflected the restrictions described in this analysis, it also reflected reluctance among some District officials to use the rainy day fund at all. Some policymakers argued that use of the rainy day fund would only delay inevitable decisions the District must make to reduce spending or increase revenues, because the District's budget problems could last for a number of years. Yet, for several reasons, it would make sense to use the rainy day fund if further budget problems arise this year and if such problems continue in fiscal year 2004.

Perhaps most important, the District already has taken dramatic action to address its budget problems. The plan to address the $323 million deficit included nearly $200 million in spending reductions in nearly every area of the District's budget, with particularly large cuts in services for children and low-income residents. (These cuts are described in a recent DC Fiscal Policy Institute analysis.[6] The deficit reduction plan also included more than $100 million in fee and tax increases, including increases in taxes on real estate transactions, utilities, cigarettes, and alcohol. If the District faces further budget shortfalls and chooses not to use the rainy day fund, residents will be forced to accept even greater cutbacks in a wide array of services or even more tax increases.

In addition, there are several reasons why the District should consider using its rainy day fund to address its current fiscal crisis.

- Drawing down rainy day funds is good for the economy. Both tax increases and spending cuts have negative economic consequences to varying degrees because they reduce demand for goods and services, therefore dampening sales, profits, and job growth. Rainy day fund withdrawals — which add demand to the economy from funds saved in better economic times — can minimize those consequences.

- Preserving a rainy day fund in the midst of a fiscal crisis is tantamount to not having a rainy day fund at all. Rainy day funds are designed specifically to provide a quick infusion of resources during a downturn to help avoid debilitating cuts to public services at the very time the services and programs are needed most. It makes little sense to save money as a means of preventing possible cuts in the future if doing so means making definite cuts in the present.

- Using rainy day funds allows a jurisdiction to maintain needed services in the short-term while it devises a more carefully considered solution to close whatever remaining budget gap it anticipates in this fiscal year and beyond.

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[6] "Dealing with the Deficit: Eliminating DC's $323 Million Budget Shortfall for 2003 Has Meant Substantial Spending Cuts, Notable Revenue Increases," (http://www.dcfpi.org/2-11-03bud.htm).

Finally, claims by some that use of rainy day fund would be perceived as fiscally irresponsible — potentially leading to a downgrade in credit rating — are inaccurate. For example, a recent Standard and Poor's publication indicated that prudent use of reserves would *not* affect a state's credit rating.

> Use of reserves is not a credit weakness in and of itself. These reserves are accumulated in order to be spent during times of budgetary imbalance and extraordinary economic events. The last month has highlighted the importance and critical nature of these reserves from a credit standpoint. Given this period of economic uncertainty, a balanced approach of adjusting spending and drawing on reserves will reduce out-year structural imbalance.[7]

For all of these reasons, District policy makers should work to improve access to DC's rainy day funds and should be willing to use the rainy day fund if current budget problems persist.

[7] Robin Prunty, Alexander M Fraser, Steven J Murphy. *Commentary: The State of the States.* Standard and Poor's, October 18, 2001.

APPENDIX I: Summary of State Rainy Day Fund Rules

State	Source of Deposits	Conditions for Withdrawal	Restriction on Withdrawal	Replenishment
Alaska	Mineral litigation settlements	When revenues decline from one year to next	None	None
		for any other purpose	3/4 vote of legislature	
Alabama	One-time funds	Revenue shortfall or to avert reductions in education spending	None	Within 5 years
Arizona*	When economic growth exceeds specified levels	When economic growth falls below specified levels	Withdrawal amount is based on the depth of the economic decline	None
California	Year-end budget Surplus	Budget deficit or disaster relief	None	None
Connecticut	Year-end budget Surplus	Budget deficit	None	None
Delaware	Year-end budget Surplus	Budget deficit or to fund tax cuts	3/5 vote of legislature	None
District of Columbia*	None	When revenue shortfall exceeds specified level, natural disaster, or emergency	No more than 44% of the fund can be used for revenue shortfall	Within 1 year
Florida: Budget Stabilization Fund	When revenues increase from one year to the next	Revenue shortfall or emergency	None	Within 5 years
Florida: Working Capital Fund	Year-end budget Surplus	Revenue shortfall or emergency	None	None
Georgia	Year-end budget Surplus	Can be used for any purpose	None	None
Hawaii	Portion of tobacco settlement funds	Revenue shortfall or emergency	2/3 vote of the legislature	None
Idaho	When revenue growth exceeds specified level	Revenue shortfall or emergency	No more than half of fund can be used in one year	None
Indiana	When economic growth exceeds specified levels	When economic growth falls below specified levels	Withdrawal amount is based on the depth of the economic decline	None
Iowa	None specified	Economic emergencies	None	None
Kentucky*	When revenues exceed initial projections	Revenue shortfall	None	None
Louisiana	Year-end budget Surplus and non-recurring funds	Revenue shortfall	2/3 vote of legislature; no more than 1/3 of fund can be used in one year	None
Maine*	Year-end budget Surplus	Can be used for any purpose	None, unless used for construction or bond payments; if so, 2/3 vote of legislature is required	None
Maryland	$50 million/year	Can be used for any purpose	None	None

State	Source of Deposits	Conditions for Withdrawal	Restriction on Withdrawal	Replenishment
Massachusetts	Year-end budget Surplus	Revenue shortfall, loss of federal funds, or event that threatens the "health, safety, or welfare…or the fiscal stability" of the state	None	None
Michigan*	When economic growth exceeds specified levels	When economic growth falls below specified levels	Withdrawal amount is based on the depth of the economic decline	None
Minnesota	Year-end budget Surplus	Budget shortfall tied to economic decline	None	None
Mississippi	Year-end budget Surplus	Revenue shortfall	None	None
Missouri	When fund is below required balance	Revenue shortfall or natural disaster	2/3 vote of the legislature; no more than half of fund can be used in one year	Within 3 years
Nebraska	When revenues exceed initial projections	Budget deficit	None	None
Nevada	Year-end budget surplus	When revenue shortfall exceeds specified level or fiscal emergency is declared	None	None
New Hampshire	Year-end budget surplus	Revenue shortfall	None	None
		For any other purpose	2/3 vote of the legislature	
New Jersey	When revenues exceed initial projections	Revenue shortfall or emergency	None	None
New Mexico*	Year-end budget surplus and appropriations	Revenue shortfall	None	None
New York	Year-end budget surplus	Budget deficit	None	Within 6 years
North Carolina	Year-end budget surplus	Can be used for any purpose	None	None
North Dakota	State bank profits	Revenue shortfall	Withdrawal limited to $25 million	None
Ohio	Year-end budget surplus	Can be used for any purpose	None	None
Oklahoma	Year-end budget surplus	When revenues decline from one year to next	No more than half can be used in one year	None
		when emergency is declared	A 2/3 vote of legislature; No more than half of fund can be used in one year	
Oregon	Portion of lottery funds	Employment decline or revenue shortfall	3/5 vote of the legislature	None
Pennsylvania	Year-end budget surplus	Revenue shortfall or emergency	2/3 vote of the legislature	None
Rhode Island *	2% of annual revenues	Revenue shortfall	None	Within 2 years
South Carolina	Year-end budget surplus	Budget deficit	None	Within 3 years

State	Source of Deposits	Conditions for Withdrawal	Restriction on Withdrawal	Replenishment
South Dakota	Year-end budget surplus	Revenue shortfall or unanticipated spending obligation	None	None
Tennessee	When revenues increase from one year to the next	Revenue shortfall or unanticipated spending obligation	Withdrawal limit is the greater of $100 million or half of the fund	None
Texas	Year-end budget surplus and excess oil taxes	Revenue shortfall	3/5 vote of the legislature	None
		For any other purpose	2/3 vote of the legislature	
Utah	Year-end budget surplus	Budget deficit or to fund tax cuts	None	None
Vermont	Year-end budget surplus	Budget deficit	None	None
Virginia	When revenue growth exceeds specified rate	When revenue shortfall exceeds specified levels	Fund can be used for no more than half of budget shortfall; no more than half of the fund can be used in one year	None
Washington	Year-end budget surplus	Revenue shortfall	2/3 vote of the legislature	None
West Virginia	Year-end budget surplus	Revenue shortfall or emergency	None	None
Wisconsin	When revenues exceed initial projections	None specified	None	None
Wyoming*	when spending is less than budgeted levels	Fund can be used for any purpose	None	None

Notes:

Arizona: The legislature can waive the formula-based deposit or withdrawal through enactment of legislation with an "emergency clause."

District of Columbia: The District has two rainy day funds, with many rules in common. This summary treats the two reserves as one rainy day fund.

Kentucky: Deposit to the rainy day fund also is required when spending falls below budgeted levels.

Maine: Based on statutory language, it appears that the Maine rainy day fund was created to be used only for bond payments or capital projects. But the fund has been used numerous times for other purposes. In practice, then, the Maine rainy day fund appears to be available for any purpose.

Michigan: The legislature can waive the formula-based deposit or withdrawal.

New Mexico: The state has three rainy day funds, with many rules in common. They are treated as one rainy day fund in this summary.

Rhode Island: The legislature is allowed to lengthen repayment beyond two years.

Wyoming: The governor is required to "recommend" that the legislature set five percent of annual revenues in the rainy day fund. This does not appear to be a mandatory contribution requirement.

Appendix II: Use of State Rainy Day Funds in 2002 and 2003

State	Rainy Day Fund Balance at End of 2001, in millions	Withdrawals in 2002 and 2003, in millions	Withdrawals as % of 2001 Balance
Alaska	$2,995	$1,250	42%
Arizona	373	393	92%
California	2,596	2,596	100%
Connecticut	595	595	100%
Florida	1,383	245	18%
Georgia	881	34	4%
Idaho	53	27	50%
Indiana	526	247	47%
Iowa	172	156	91%
Kentucky	240	240	100%
Louisiana	197	24	12%
Maine	144	144	100%
Maryland	888	394	44%
Massachusetts	2,294	1,997	85%
Michigan	994	963	97%
Minnesota	622	304	49%
Mississippi	190	61	32%
Nebraska	170	108	64%
Nevada	136	100	73%
New Jersey	720	720	100%
New Mexico	370	143	39%
North Carolina	157	157	100%
Ohio	1,011	940	93%
Oklahoma	341	304	89%
Pennsylvania	1,037	726	70%
South Carolina	61	61	100%
South Dakota	111	32	29%
Utah	120	110	92%
Vermont	43	25	58%
Virginia	716	248	35%
Washington	462	407	88%
West Virginia	79	21	27%
Wyoming	109	81	79%

Source: Center on Budget and Policy Priorities, 2003